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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-566

LOUIS J. MARTINO and McDONALD'S DRIVE-IN of OTTUMWA, IOWA, INC.,

Petitioners,

vs.

McDONALD'S SYSTEM, INC., and FRANCHISE REALTY INTERSTATE CORP.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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McDONALD'S SYSTEM, INC., and FRANCHISE REALTY INTERSTATE CORP.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Petitioners, Louis J. Martino and McDonald's Drive-In of Ottumwa, Iowa, Inc., respectfully pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this proceeding on May 9, 1979.

OPINIONS BELOW.

The opinion of the Court of Appeals, reported at 598 F. 2d 1079, is reprinted in the Appendix hereto at pp. A1-A12. The opinion of the United States District Court for the Northern

District of Illinois, reported at 432 F. Supp. 499, is reprinted in the Appendix at pp. A15-A27. The unreported opinion of the District Court denying Petitioners' Motion for Reconsideration is reprinted in the Appendix at p. A29.

JURISDICTION.

The judgment of the Court of Appeals was entered on May 9, 1979. On August 2, 1979, Mr. Justice Stevens extended the time for filing a petition for writ of certiorari to and including September 11, 1979. On August 29, 1979, Mr. Justice Stevens further extended the time for filing a petition to and including October 6, 1979. This Court's jurisdiction is invoked under 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED.

(1) Did the Court of Appeals improperly ignore the settled rule of *Mercoid* v. *Mid-Continent Investment Co.*, 320 U. S. 661 (1944), when it held that petitioners' antitrust claim was rendered *res judicata* by the settlement of an earlier action against petitioner that had nothing to do with the antitrust laws?

(2) Did the Court of Appeals improperly disrupt the clear procedure prescribed by the compulsory counterclaim rule, F. R. Civ. P. 13(a), by inventing a new and unforeseeable *res judicata* doctrine to bar a subsequent antitrust claim by a petitioner who had settled an earlier suit before Rule 13(a) required him to raise that claim?

STATUTES AND RULES INVOLVED.

Rule 13(a) of the Federal Rules of Civil Procedure provides:

> Compulsory Counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the sub-

ject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction. But the pleader need not state the claim if (1) at the time the action was commenced the claim was the subject of another pending action, or (2) the opposing party brought suit upon his claim by attachment or other process by which the court did not acquire jurisdiction to render a personal judgment on that claim, and the pleader is not stating any counterclaim under this Rule 13.

STATEMENT OF THE CASE.

Petitioners seek review of a judgment of the Court of Appeals affirming the dismissal of Count I of their two-count antitrust lawsuit. Petitioners filed their Complaint in the United States District Court for the Northern District of Illinois on October 14, 1975. The District Court had jurisdiction pursuant to 28 U. S. C. § 1337.

Count I of the Complaint grows out of Respondents' termination of Petitioners' franchise in 1973 for allegedly violating a provision of the Franchise Agreement which forbade the franchisee or any member of his immediate family from acquiring a financial interest in any other self-service food business, except with written consent of the franchisor. Petitioners alleged that McDonald's enforcement of this provision of the Franchise Agreement in this particular case violated Section 1 of the Sherman Act, 15 U. S. C. § 1.

The pertinent facts are as follows. In 1962, Petitioner Louis J. Martino and three of his brothers entered into a franchise and lease agreement with Respondents McDonald's System, Inc., which licenses McDonald's franchises, and Franchise Realty Interstate Corporation, Inc. ("FRIC"), a McDonald's affiliate that leases property to McDonald's franchisees. Petitioner Martino and his brothers then organized Petitioner McDonald's Drive-In of Ottumwa, Iowa, Inc. to operate the business.

In 1968, Louis Martino financed his son's purchase of a Burger Chef franchise in Pittsburg, Kansas, approximately 380 miles from Ottumwa. No McDonald's existed in Pittsburg. Petitioner Martino continued to live in Ottumwa and to operate his McDonald's restaurant.

In 1972, Respondents sued Louis Martino and his three brothers to terminate the Ottumwa franchise for violation of a provision in the Franchise Agreement that forbade the franchisee or any member of his immediate family from acquiring a financial interest in any other self-service food business, except with written consent of the franchisor. This breach of contract diversity lawsuit was filed in the Federal District Court in the Southern District of Iowa. No answer was ever filed by the Martinos. Instead, the Martinos filed a motion under Rule 12, F. R. Civ. P., to strike or for a more definite statement. After these motions were denied, the parties commenced extended settlement negotiations. At no time did McDonald's move to default Petitioner Martino.

At the time, Petitioner Louis Martino was under intense pressure from his brothers (who owned other McDonald's franchises and feared the consequences of fighting the lawsuit) and from the tragedy of his wife's recent death to accept a consent decree in which he and his brothers agreed to sell the business to an affiliate of FRIC. Thus, the McDonald's franchise termination claim (and nothing else) was settled on September 5, 1973, by a consent decree signed by the Martinos. McDonald's did not seek a release of any claim the Martinos may have had against them.

On October 14, 1975, Petitioners filed this lawsuit. On March 30, 1976, Respondents moved for summary judgment or dismissal. Their motion contended, *inter alia,* that Petitioner Martino's failure to assert the antitrust claim in the prior contract suit barred the present action, under both the compulsory counterclaim provisions of Rule 13(a), F. R. Civ. P., and the doctrine of *res judicata.*

On May 18, 1977, the District Court granted summary judgment against Petitioner Martino on Count I of his Complaint. The court found (a) that Petitioners' antitrust claims in Count I were to be construed as compulsory counterclaims under Rule 13(a); (b) that Rule 13(a)'s counterclaim provisions barred this action despite the fact that no answer or responsive pleading was filed by the Martinos in the prior Iowa litigation; and (c) that the same result was dictated by the principles of *res judicata*. On March 6, 1978, the District Court denied Petitioners' Motion to Reconsider and granted summary judgment on Count I against Petitioner McDonald's Drive-In of Ottumwa, Iowa, Inc. Pursuant to Rule 54(b), F. R. Civ. P., the District Court directed the entry of final judgment on Count I on March 20, 1978.

On appeal, the Court of Appeals for the Seventh Circuit ruled that the compulsory counterclaim provisions of Rule 13(a) were inapplicable, because no answer had ever been filed in the prior contract litigation. Nevertheless, the Court of Appeals held that Petitioners' antitrust claim was barred. The court held that principles of *res judicata* established a narrowly defined class of common law compulsory counterclaims. Petitioners' claim was found to come within this category because its successful prosecution would nullify rights established in earlier litigation. The Court of Appeals therefore affirmed the judgment of the District Court.

REASONS FOR GRANTING THE WRIT.

I.

The Ruling Below Is Directly Contrary to This Court's Decision in Mercoid v. Mid-Continent Investment Co.

The law which should control in this case was clearly and succinctly stated by this Court in *Mercoid* v. *Mid-Continent Investment Co.*, 320 U. S. 661 (1944). The question in *Mercoid* was whether defendant Mercoid could assert an antitrust

counterclaim in a patent infringement action. Plaintiff Mid-Continent argued that the antitrust claim was barred by the doctrine of *res judicata,* because it could have been used as both a defense and a counterclaim in prior litigation which upheld the validity of Mid-Continent's patent. Squarely rejecting that argument, this Court held that an antitrust claim is "a separate statutory cause of action"; consequently, "[t]he fact that it might have been asserted as a counterclaim in the prior suit . . . does not mean that the failure to do so renders the prior judgment *res judicata* as respects it." *Id.* at 671.

The decision below directly contravenes the holding in *Mercoid.* Because Petitioners' antitrust claim stands as an independent statutory cause of action, the failure to raise it in the prior common law action for breach of contract could not preclude their right to bring a subsequent antitrust suit. The Seventh Circuit decision that *res judicata* bars Petitioners' claim rests on an unwarranted narrowing of this Court's holding in *Mercoid.*

Recognizing that *Mercoid* guarantees the survival of some antitrust counterclaims, the court below would limit *Mercoid's* protection to antitrust claims involving patent abuse. There is no basis for distinguishing patent abuse antitrust claims from other antitrust claims, such as the franchise abuse antitrust claim that Petitioners seek to assert. Patent abuse antitrust claims and franchise abuse antitrust claims are simply variants of the same federal statutory cause of action, and *Mercoid* declares that this cause of action is an independent one.

The Court of Appeals' disregard of *Mercoid* is particularly serious because of the well-recognized importance of private efforts to enforce the antitrust laws. Both the Congress and this Court have created special rules to ensure that the claims of antitrust plaintiffs receive a full hearing on their merits.[1] As this Court has stated:

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1. Congress has favored antitrust plaintiffs by allowing them to use a civil judgment or criminal conviction in a government action

(Footnote continued on next page.)

> [Antitrust] laws protect the victims of the forbidden practices as well as the public . . . Congress itself has placed the private antitrust litigant in a most favorable position through the enactment of § 5 of the Clayton Act . . . In the face of such a policy this Court should not add requirements to burden the private litigant beyond what is specifically set forth by Congress in those laws.

Radovich v. *National Football League*, 352 U. S. 445, 454 (1957). The *Mercoid* decision serves as an important part of this policy because it prevents the unknowing waiver of antitrust claims by a litigant sued on another cause of action.

In sum, *Mercoid* controls this case. This Court has never overruled, disavowed, or narrowed the holding of that decision. Until the decision below, *Mercoid* uniformly had been followed by the lower federal courts.[2] Petitioner had a right to rely on the protection of the *Mercoid* rule when he settled the contract action against him. The Seventh Circuit's refusal to follow *Mercoid* is clear error, and must be reversed.

(Footnote continued from preceding page.)

as *prima facie* evidence of a civil violation. 15 U. S. C. § 16. Congress has made special rules encouraging states to become antitrust plaintiffs on behalf of their citizens. 15 U. S. C. § 15c. Congress has authorized court-awarded attorneys' fees to antitrust plaintiffs, but not to antitrust defendants. 15 U. S. C. § 15. This Court has carved out for antitrust plaintiffs an exception to the equitable doctrine of *in pari delicto*. *Perma Life Mufflers, Inc.* v. *Intern Parts Corp.*, 392 U. S. 134, 138 (1968). This Court has also limited the use of certain other defenses to antitrust suits, notably the "pass-on defense". *Hanover Shoe, Inc.* v. *United States Shoe Machinery Corp.*, 392 U. S. 481 (1968).

2. *See, e.g., Agrashell, Inc.* v. *Hammons Products Co.*, 479 F. 2d 269 (8th Cir. 1973), *cert. denied*, 414 U. S. 1022 (1973); *Fowler* v. *Sponge Products Corp.*, 246 F. 2d 223 (1st Cir. 1957); *Switzer Bros., Inc.* v. *Locklin*, 207 F. 2d 483 (7th Cir. 1953), *cert. denied*, 347 U. S. 912 (1953); *Reagan* v. *Commonwealth Theatres of Puerto Rico, Inc.*, 300 F. Supp. 676 (D. P. R. 1969); *Moore Co. of Sykeston, Mo.* v. *Sid Richardson Carbon & Gasoline Co.*, 237 F. Supp. 817 (E. D. Mo. 1964), *rev'd on other grounds*, 347 F. 2d 921 (8th Cir. 1965), *cert. denied*, 383 U. S. 925 (1965); *Gasswint* v. *Clapper*, 17 F. R. D. 309 (W. D. Mo. 1955); *Douglas* v. *Wisc. Alumni Research Foundation*, 81 F. Supp. 167 (N. D. Ill. 1948).

II.

The Decision Below Is Inconsistent with the Rule That Res Judicata Only Bars Relitigation of the Same Cause of Action.

As this Court has recognized, the application of *res judicata* imposes an extreme sanction. Only last Term this Court again emphasized the caution that must accompany the use of *res judicata:* because "it blockades unexplored paths that may lead to the truth," *res judicata* "is to be invoked only after careful inquiry." *Brown* v. *Felsen,* 99 S. Ct. 2205, 2209-10 (1979). Thus although the doctrine has a proper role to play in serving the interest of finality, that role must be narrowly and carefully confined.

The single most important limit on the doctrine's scope is the rule that *res judicata* applies only upon the subsequent assertion of the same cause of action involved in a prior suit. Where the second suit is based on a separate cause of action, the less severe bar of collateral estoppel precludes only the relitigation of issues actually and necessarily decided in the prior litigation. This "separate cause of action" rule has been repeated by this Court too often and too recently to be open to challenge. *See Montana* v. *United States,* 99 S. Ct. 970, 973-74 (1979); *Sea-Land Services, Inc.* v. *Gaudet,* 414 U. S. 573, 578 (1974); *Commissioner of Internal Revenue* v. *Sunnen,* 333 U. S. 591, 597-98 (1948); *Cromwell* v. *County of Sac,* 94 U. S. 351, 352 (1876).

Despite this weight of authority, the opinion below departs from the same-cause-of-action rule and creates an exception that has never been recognized by this Court. The Court of Appeals acknowledged that Petitioners' antitrust claim involved a different cause of action than the common law contract claim that had previously been settled by consent decree.[3] Under the

3. *Martino* v. *McDonald's System, Inc.,* 598 F. 2d 1079, 1085 (7th Cir. 1979) ("the suit . . ., like the antitrust claim here, was a different cause of action") (App., p. A10).

rule declared by this Court, this should have resulted in the application of collateral estoppel. The Court of Appeals declined, however, to follow the established rule. Instead, the Seventh Circuit has now adopted a rule that extends the scope of *res judicata* into situations involving two suits on separate causes of action, provided only that the outcome in the second suit could be said to nullify some right created by the prior judgment.

The rule created by the Seventh Circuit is a dangerous one, and it is contrary to the decisions of this Court. It is dangerous because it permits the foreclosure in its entirety of a cause of action that has never been litigated. Moreover, the rule is incompatible with the outcome in *Mercoid*. The earlier *Mercoid* litigation established the validity of Mid-Continent's patent. The *Mercoid* decision nevertheless assessed damages under the antitrust laws for conduct engaged in pursuant to the declaration of rights in the earlier suit. If the Seventh Circuit rule were the law, this nullification of adjudicated rights would have called for the application of *res judicata*. This Court explicitly declined, however, to apply *res judicata*. Adhering to the same-cause-of-action rule, this Court affirmed Mercoid's right to be heard on its separate cause of action under the antitrust laws.

III.

The Seventh Circuit's Creation of a Common Law Compulsory Counterclaim Rule Disrupts Orderly Adjudication Under the Federal Rules of Civil Procedure.

Rule 13(a) of the Federal Rules of Civil Procedure provides that a pleading must state as a counterclaim any claim the pleader has which arises out of the same transaction or occurrence. This Court has ruled that a counterclaim not so raised cannot be heard in a separate suit. *Baker* v. *Gold Seal Liquors, Inc.*, 417 U. S. 467, 469 n. 1 (1974). Because the sanction is a severe one, it must be applied carefully within the confines of Rule 13(a).

By its terms, the compulsory counterclaim rule does not come into force until a responsive pleading has been filed. The language of Rule 13(a) is explicit: it is a *pleading* that must state a counterclaim. The federal courts are in agreement that where an earlier suit was resolved before an answer was filed, Rule 13(a) does not bar the defendant from bringing a later suit.[4] Thus totally apart from the fact that Petitioner Martino's claim asserts a separate cause of action, his antitrust suit should not have been barred because the prior action was terminated before an answer was filed.

The Seventh Circuit recognized that Rule 13(a) was inapplicable in this case. Nevertheless, the Court of Appeals refused to allow Petitioners' action to proceed. It reached this result by creating a common law rule of compulsory counterclaims that sweeps aside the express limitation contained in Rule 13(a). The Court of Appeals' action is improper for two reasons. First, it disregards the important policy considerations that underlie the careful phrasing of Rule 13(a). Second, it undermines orderly adjudication under the Federal Rules of Civil Procedure by penalizing a litigant for his reliance on those rules.

Sound policy supports the rulemakers' decision to defer the application of Rule 13(a) until a party files a responsive pleading. From the standpoint of efficiency and judicial economy, little is lost by allowing a defendant to bring a subsequent suit on what might have been a counterclaim, since a pre-answer settlement consumes very little judicial time. A party who desires protection from the possibility of a future suit is free to seek a broader settlement and appropriate releases. Where, however, a party has taken the advantages of a speedy resolution

4. *Dindo* v. *Whitney*, 451 F. 2d 1 (1st Cir. 1971) (earlier case settled); *Lawhorn* v. *Atlantic Refining Co.*, 299 F. 2d 353 (5th Cir. 1962) (earlier case dismissed pursuant to Rule 12 motions); *Reagan* v. *Commonwealth Theaters of Puerto Rico*, 300 F. Supp. 676, 677 n. 1 (D. P. R. 1969) (earlier case voluntarily dismissed with prejudice); *United States* v. *Thompson*, 262 F. Supp. 340 (S. D. Tex. 1966) (earlier case dismissed by plaintiff); *Potter* v. *Carvel Stores of New York, Inc.*, 203 F. Supp. 462, 464 (D. Md. 1962), *aff'd on other grounds*, 314 F. 2d 45 (4th Cir. 1963).

of the first suit, it is not unjust to impose, as the price, a limitation on the preclusive effect of the consent judgment. Such a limitation permits the parties to settle expeditiously those claims they wish to resolve. At the same time, it prevents the precipitous and unknowing waiver of related claims not addressed on the face of the complaint or in the terms of the settlement agreement or consent decree.

The creation of a common law rule of compulsory counterclaims is incompatible with the orderly adjudication of claims under the Federal Rules of Civil Procedure. Professor Moore has described the important functions of a procedural system governed by a codified set of rules: "[E]xplicit procedural treatment forces the system to take a position on a fundamental principle, gives notice to the parties as to what that principle is, and provides a basis for evolving a uniformity of decisions by federal courts." 3 Moore's *Federal Practice*, ¶ 13.12[1]. These purposes are defeated when a Court of Appeals retroactively broadens the scope of a rule that is clearly stated and carefully circumscribed. The unfairness to a litigant who relied on the rules is manifest.

Res judicata is a flexible, judicially created doctrine that historically has given way where practicality and justice so require. *Spilker* v. *Hankin*, 188 F. 2d 35, 39 (D. C. Cir. 1951). The decision to include the pleading requirement as a trigger in Rule 13(a) represents a codified form of the ordinary adjustments and accommodations of *res judicata*. That codification should have been respected by the court below, both because Rule 13(a) reflects sound policy, and because Petitioners had a right to rely on that rule.

CONCLUSION.

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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October 3, 1979.

APPENDIX.

IN THE UNITED STATES COURT OF APPEALS
For the Seventh Circuit

No. 78-1480

LOUIS J. MARTINO and McDONALD'S DRIVE-IN OF OTTUMWA, IOWA, INC.,

Plaintiffs-Appellants,

vs.

McDONALD'S SYSTEM, INC. and FRANCHISE REALTY INTERSTATE CORPORATION,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 75-C-3455—Joel M. Flaum, *Judge.*

ARGUED NOVEMBER 30, 1978—DECIDED MAY 9, 1979

Before FAIRCHILD, *Chief Judge,* PELL and WOOD, *Circuit Judges.*

PELL, *Circuit Judge.* The plaintiffs, Louis J. Martino and McDonald's Drive-In of Ottumwa, Iowa, Inc., (McDonald's Ottumwa) appeal from the district court's entry of summary judgment against them on one count of their two count antitrust complaint against the defendants, McDonald's System, Inc.

(McDonald's System) and Franchise Realty Interstate Corporation (FRIC). The only issue before this court is whether a 1973 consent judgment against Martino precludes the cause of action set forth in Count I of the present complaint. The district court held that both res judicata and the compulsory counterclaim rule of Fed. R. Civ. P. 13(a) barred the plaintiffs from suing on their first cause of action. *Martino* v. *McDonald's System, Inc.*, 432 F. Supp. 499 (N. D. Ill. 1977).

In 1962 the plaintiff Louis Martino and three brothers not involved in this action entered into a franchise and lease agreement with the defendants.[1] Martino and his brothers then organized McDonald's Ottumwa, the corporate plaintiff here, to operate the business. The contract to which Martino and the defendants were parties provided that neither Martino nor a member of his immediate family would acquire a financial interest in a competing self-service food business without the written consent of McDonald's System and FRIC. In 1968 Martino's son purchased a Burger Chef franchise in Pittsburg, Kansas. Martino financed this transaction.

On the basis of this transaction FRIC and McDonald's System brought a federal diversity action in Iowa against Martino and his three brothers, charging that Martino had violated the contract provision restricting acquisitions described above. This lawsuit, commenced in 1972, ended in 1973 with a consent judgment to which the district court appended findings of fact and conclusions of law. The court order also provided that the parties had entered an agreement for the sale of McDonald's Ottumwa franchise to FRIC for $140,000. The sale was completed according to the terms of the agreement. Martino's brothers later cancelled their stock in McDonald's Ottumwa, leaving Martino as the sole shareholder.

Martino and McDonald's Ottumwa brought this action in 1975. Count I of their complaint alleges that the enforcement

1. The defendant McDonald's System, Inc. licensed the McDonald's franchise, and the defendant FRIC leased the property for the franchise.

of the restriction on acquisition in the franchise and lease agreements violated Section 1 of the Sherman Act, 15 U. S. C. § 1. As a basis for damages, Martino claims profits he would have earned as owner of the McDonald's franchise. Both plaintiffs claim damages for having had to sell the franchise, allegedly below its market value.

The defendants have presented two theories for barring Count I of the plaintiffs' antitrust complaint. The first theory is based on the preclusive effect of Fed. R. Civ. P. 13(a), applying to compulsory counterclaims. The second theory is based on the principle of res judicata. We shall now consider the merits of each theory.

The defendants argue that the district court correctly held that Count I is precluded by Fed. R. Civ. P. 13(a).[2] Claims coming within the definition of "compulsory counterclaim" are lost if not raised at the proper time. *Baker* v. *Gold Seal Liquors, Inc.*, 417 U. S. 467, 469, n. 1 (1974); *Fagnan* v. *Great Central Insurance Co.*, 577 F. 2d 418 (7th Cir.), *cert. denied*, 47 U. S. L. W. 3391 (1978). According to the defendants, Rule 13(a) required Martino to raise this antitrust challenge to the contract provision in the earlier suit based on the same provision. If Rule 13(a) were applicable to these facts, the defendants' argument might have merit.[3] Rule 13(a), however, by its own terms does not apply unless their has been some form of pleading.

2. Rule 13(a) provides in pertinent part:

> A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction. . . .

3. Martino argues, however, that *Mercoid Corp.* v. *Mid-Continent Investment Co.*, 320 U. S. 661 (1944) requires special treatment of antitrust counterclaims. We consider this argument as it applies to the res judicata theory of preclusion, *infra*. Because we decline to apply Rule 13(a) in the circumstances of this case, we do not consider the merits of Martino's argument that *Mercoid* requires that all antitrust counterclaims be treated as permissive counterclaims under Fed. R. Civ. P. 13(b).

The rule expressly says that "a *pleading* shall state as a counterclaim any claim which at the time of serving the *pleading* the *pleader* has against any opposing party. . . ." (Emphasis added). In the prior Iowa action at issue here, Martino filed no pleading as the word is defined in Fed. R. Civ. P. 7(a).[4] For this reason, Martino argues that we must not apply Rule 13(a) to the claim stated in Count I of his complaint. We agree.

Rule 13(a) is in some ways a harsh rule. It forces parties to raise certain claims at the time and place chosen by their opponents, or to lose them. The rule, however, is the result of a balancing between competing interests. The convenience of the party with a compulsory counterclaim is sacrificed in the interest of judicial economy. *See Southern Construction Co.* v. *Pickard,* 371 U. S. 57, 60 (1962); *Dindo* v. *Whitney,* 451 F. 2d 1, 3 (1st Cir. 1971). We do not believe that the drafters of Rule 13 chose the term "pleading" unadvisedly. It no doubt marks, although somewhat arbitrarily, a point at which the judicial burden of the earlier lawsuit outweighs the opposing party's interest in bringing an action when and where it is most convenient. The earlier action between these parties was terminated by a consent judgment before the answer was filed. We see little sense in applying the broad bar established in Rule 13(a) to an action that ended with virtually no burden on the judicial calendar.

McDonald's System and FRIC emphasize, however, that the deadline for filing the answer in the earlier action had passed,[5] and that Rule 13(a) should therefore apply regardless of the absence of a responsive pleading. Citing as support several cases construing rules similar to Rule 13(a), *Brenner* v. *Mitchum, Jones & Templeton, Inc.,* 494 F. 2d 881 (9th Cir. 1974) (California rule); *Mensing* v. *Sturgeon,* 97 N. W. 2d

4. Rule 7(a) defines the following as pleadings: an answer, a reply to a counterclaim, an answer to a crossclaim, a third party complaint, and a third party answer.

5. Almost immediately after the complaint was filed, the parties entered into settlement negotiations. The resulting consent judgment was entered before Martino filed an answer.

145, 149 (Iowa 1959); *Keller* v. *Keklikian*, 244 S. W. 2d 1001, 1004-05 (Mo. 1951); *Friedrichsen* v. *Cobb*, 275 P. 267, 271 (Mont. 1929); *McDonald* v. *Krause*, 362 P. 2d 724, 729 (Nev. 1961); *Harris* v. *Jones*, 404 S. W. 2d 349, 351-52 (Tex. Civ. App. 1966); *see also Firemen's Insurance Co* v. *L. P. Steuart & Bros., Inc.*, 158 A. 2d 675, 677 (D. C. Mun. App. 1960) (construing Fed. R. Civ. P. 13(a)), McDonald's System and FRIC argue that to hold otherwise is to reward noncompliance with the Federal Rules. We believe that this argument exaggerates the effect of not applying Rule 13(a). The Rules themselves provide for default judgments against a party for failure to plead, Fed. R. Civ. P. 55, and the effect of such a judgment as res judicata, *Morris* v. *Jones*, 329 U. S. 545, 550-51 (1947); 1B Moore's Federal Practice ¶ 0.409[4] (2d ed. 1974), prevents the nonpleading party from profiting as the result of his noncompliance.[6] *See also* Restatement (Second) of Judgments § 56.1, Comment a (Tent. Draft No. 1, 1973).

Although Rule 13(a) does not dispose of Martino's antitrust claim, long-standing principles of res judicata establish a narrowly defined class of "common law compulsory counterclaims." *See* Restatement (Second) of Judgments § 56.1(2)(b), Reporter's Note on Comment f (Tent. Draft No. 1, 1973). We hold that the antitrust claim set forth in Count I of Martino's complaint falls within this narrow class of claims and that the res judicata effect of the earlier consent judgment is a bar to raising it now.

The principle of res judicata at issue here treats a judgment on the merits as an absolute bar to relitigation between the parties and those in privity with them[7] of every matter offered

6. As indicated by our discussion of the res judicata effect of the consent judgment, see text *infra*, we do not imply that default judgments for failure to plead create, on the basis of res judicata, a bar to counterclaims co-extensive with that in 13(a). We merely demonstrate that the potential for abuse of the counterclaim rule is too small to justify reading the pleading requirement out of the rule.

7. Martino argues that even if the compulsory counterclaim rule of 13(a) were applicable to him, it would not apply to the corpo-

(Footnote continued on next page.)

and received to sustain or defeat the claim or demand and to every matter which might have been received for that purpose. *Commissioner* v. *Sunnen*, 333 U. S. 591, 597 (1948); *Chicot County Drainage District* v. *Baxter State Bank*, 308 U. S. 371, 375 (1940); *Cromwell* v. *County of Sac*, 94 U. S. 351, 352 (1876).

The conclusion of the earlier contract lawsuit with a consent judgment does not prevent the earlier judgment from having a res judicata effect. *Beloit Culligan Soft Water Service, Inc.* v. *Culligan Inc.*, 274 F. 2d 29, 35 (7th Cir. 1959); 1B Moore's Federal Practice ¶ 0.409[5], at 1026 (2d ed. 1974). *See Lawlor* v. *National Screen Service*, 349 U. S. 322, 327 (1955); *United States* v. *Swift & Co.*, 286 U. S. 106, 115 (1932); *Brunswick Corp.* v. *Chrysler Corp.*, 287 F. Supp. 776, 777 (E. D. Wis. 1968). The plaintiffs argue that the former judgment has no res judicata effect because the parties did not sign mutual releases. We recognize that if a consent decree is expressly entered without prejudice or reserving rights the decree will not have a preclusive effect. *Brunswick Corp.* v. *Chrysler Corp., supra.* The mere absence of releases, however, is insufficient to indicate the unambiguous intent of the parties to counteract what would otherwise be the preclusive effect of the judgment. Although the earlier judgment at issue here was entered pursuant to the agreement of the parties, it was accompanied by judicial findings of fact and conclusions of law that go to the merits of the controversy. The court described Martino's actions as "a material breach of the agreements sufficient to justify termination."[8]

(Footnote continued from preceding page.)

rate plaintiff, which was not a party to the prior action. Martino, however, correctly does not dispute that the corporate plaintiff here is in privity with Martino for purposes of applying res judicata. Because we hold that Martino and McDonald's Ottumwa are in privity for purposes of res judicata, all references to Martino in our discussion of the res judicata issue refer as well to the corporate plaintiff.

8. The court held that

> the defendant, Louis J. Martino, or a member of his immediate family, has violated the terms of the sublease and the franchise

(Footnote continued on next page.)

The trial "court is not properly a recorder of contracts, but is an organ of government constituted to make judicial decisions and when it has rendered a consent judgment it has made an adjudication." 1B Moore's Federal Practice ¶ 0.409[5] at 1030 (2d ed. 1974).

Having determined that the prior consent judgment is an adjudication on the merits, we conclude that this judgment precludes Count I of this antitrust action. As a predicate for our discussion of the res judicata effect of the prior judgment we turn to the basis of Martino's present antitrust claim.

The gravamen of Count I of Martino's antitrust complaint is the 1973 lawsuit. In paragraph 12 of Count I, the complaint describes the 1973 lawsuit seeking termination of the franchise. Paragraph 13 continues, describing the personal pressures on Martino to settle the suit.[9] Paragraph 15 alleges that

> By enforcing the provisions of the franchise agreement and the sub-lease that prohibited the acquisition of any financial interest in a non-McDonald's self service food and beverage establishment against plaintiffs, defendants discouraged competition and unreasonably restrained trade and commerce in violation of Section 1 of the Sherman Act (15 U. S. C. § 1).

Paragraph 16 concludes Count I, alleging that Martino lost profits he would have earned as owner of the McDonald's franchise and that Martino was forced to sell the franchise at below its market value.

It is impossible to interpret this count as anything but a direct challenge to the outcome of the 1973 lawsuit. The 1973 law-

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> agreement by engaging in a business in which food and beverages are dispensed other than the location covered by the agreements without the prior consent of Franchise Realty or McDonald's System, and that such action constitutes a material breach of agreement sufficient to justify termination.

9. The personal pressures were not attributable to the defendants but were in part from his brothers who owned other McDonald's franchises which they feared might be jeopardized by fighting the lawsuit and in part from the recent death of his wife.

suit concluded that termination was justified. The plaintiff now contends that termination was not justified, because the federal antitrust laws forbade it. If Martino's antitrust theory had merit, it would have been a defense in 1973, changing the outcome of the litigation. *Milsen Company* v. *Southland Corporation* 454 F. 2d 363 (7th Cir. 1971).

The well-settled rule for the purpose of determining the res judicata effect of a judgment is that a "cause of action" comprises defenses, such as the alleged antitrust violation here, that were or might have been raised. As the Supreme Court said long ago:

> [A judgment on the merits] is a finality as to the claim or demand in controversy, concluding parties, and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose. Thus, for example, a judgment rendered on a promissory note is conclusive as to the validity of the instrument and the amount due upon it, although it be subsequently alleged that perfect defenses actually existed, of which no proof was offered, such as forgery, want of consideration, or payment. If such defenses were not presented in the action, and established by competent evidence, *the subsequent allegation of their existence is of no consequence.*

Cromwell v. *County of Sac,* 94 U. S. 351, 352 (1876) (emphasis added). *See Chicot County Drainage District* v. *Baxter State Bank,* 308 U. S. 371, 375 (1940); *Lambert* v. *Conrad,* 536 F. 2d 1183, 1185 (7th Cir. 1976).

Because the alleged antitrust violation constitutes a separate ground for recovery as well as a defense to the suit to terminate the franchise, however, Martino argues that Count I of this action constitutes a different "cause of action" for the purpose of res judicata and that the prior judgment does not preclude relitigation of the defendants' termination rights under the antitrust laws. For cases like this one, to which Rule 13(a) is in-

applicable, Martino's argument correctly states the general rule. When facts form the basis of both a defense and a counterclaim, the defendant's failure to allege these facts as a defense or a counterclaim "does not preclude him from relying on those facts in an action subsequently brought by him against the plaintiff." Restatement (Second) of Judgments § 56.1(1), Comment b (Tent. Draft No. 1, 1973). *Virginia-Carolina Chemical Co.* v. *Kirven,* 215 U. S. 252 (1909); Scott, *Collateral Estoppel by Judgment,* 56 Harv. L. Rev. 1, 27 (1942). The logic of this rule in circumstances not subject to Rule 13(a) is manifest. Should the earlier litigation end in its very first stage, no great burden on the courts results from permitting a counterclaim to be raised at a more convenient time and place. Notions of judicial economy give way to fairness. The defendant in the earlier action has his day in court when and where he sees fit.

The rule is not absolute, however. Both precedent and policy require that res judicata bar a counterclaim when its prosecution would nullify rights established by the prior action. Judicial economy is not the only basis for the doctrine of res judicata. Res judicata also preserves the integrity of judgments and protects those who rely on them. McDonald's System and FRIC have terminated and repurchased Martino's franchise in reliance on the trial court's 1973 judgment telling them they were justified in doing so. Now Martino seeks to impose significant financial liability on the defendants for these actions. We cannot hold that the counterclaim exception to the res judicata rule, based merely on notions of convenience, permits the plaintiff here to wage this direct attack on the rights established by the prior judgment.

A comparison between two Supreme Court decisions illustrates the rule and the exception to the rule we have discussed. In *Chicot County Drainage District* v. *Baxter State Bank,* 308 U. S. 371 (1940), a case similar in relevant respects to the one before us, the Supreme Court applied res judicata to preclude a claim. In *Chicot County* the Court held that a judgment effecting

a plan of readjustment of indebtedness, resulting in a cancellation of certain bonds, precluded a subsequent suit on the same bonds. The subsequent suit on the bonds alleged the unconstitutionality of the 1934 Readjustment Act which was the basis of the prior action. Although the question of constitutionality in *Chicot County*, like the antitrust issue here, was not actually litigated in the earlier action, and although the suit to recover on the bonds, like the antitrust claim here, was a different cause of action, the Supreme Court applied the principle of res judicata to bar the second action. The Court explained:

> As parties, these bondholders had full opportunity to present any objections to the proceeding. . . . Apparently no question of validity was raised and the cause proceeded to decree on the assumption by all parties and the court itself that the statute was valid. . . . If the general principles of *res judicata* are applicable, these bondholders, having the opportunity to raise the question of invalidity, were not the less bound by the decree because they failed to raise it.

308 U. S. at 375. The unfairness of subjecting the issuer of the bonds in *Chicot County* to inconsistent obligations was manifest, and res judicata precluded that result.

In contrast, in *Virginia-Carolina Chemical Co.* v. *Kirven*, 215 U. S. 252 (1909), a purchaser sued for damages to his crops caused by the defendant's fertilizer. The defendant chemical company argued that its earlier successful suit against the purchaser for the price was a bar to the present suit. The Supreme Court held that the purchaser was entitled to bring the action for damages, drawing a distinction between claims which is crucial to the result in this case. A claim for crop damage in the earlier action for the purchase price would merely have effected a set-off to the Chemical Company's recovery of the purchase price. The claim for crop damage "did not go to the validity of the [Chemical Company's] demand [for the price] in its inception . . . such as . . . forgery, want of consideration, or payment." 215 U. S. at 257. Concluding that Martino's claim set forth in Count I of his complaint is a direct attack on the

termination rights established in the earlier judgment, we hold that Martino is barred from raising that claim. *See also Miller* v. *Meinhard*, 462 F. 2d 358 (5th Cir. 1972); Restatement (Second) of Judgments § 56.1, Reporter's Note on Comment b (Tent. Draft No. 1, 1973).

Finally, we add that the Supreme Court's decision in *Mercoid* v. *Mid-Continent Investment Co.*, 320 U. S. 661 (1944), does not establish an exception to this rule of res judicata for antitrust claims. In *Mercoid* the Court refused to apply res judicata to bar not only a counterclaim, but a defense as well. In an earlier patent infringement action, the defendants would have had available to them a defense to the infringement claim based on the theory that the plaintiff's patent licensing agreement unlawfully expanded the patent monopoly to unpatentable products. In *Mercoid* the defendants raised this defense for the first time. The Court, however, refused to apply res judicata to bar the use of the defense because of the strong public policy "which has led this Court in the past to withhold aid from a patentee in suits for either direct or indirect infringement where the patent was being misued." 320 U. S. at 670.

Similarly, the Court, citing the *Virginia-Carolina Chemical* decision we discussed above, permitted the *Mercoid* defendant to raise an antitrust counterclaim based on the same theory of patent misuse. The Court's res judicata analysis in *Mercoid*, based on an examination of the policies involved, was no different than ours here.[10] In contrast, however, the Court in *Mercoid* added an additional, decisive consideration to the res judicata balance: the public policy requiring proper restriction of patent monopolies.[11] Because Martino's antitrust action has not been

10. As we have already noted, see note 3 *supra*, we express no view on the merits of the plaintiffs' argument that *Mercoid* classifies all antitrust claims as permissive counterclaims under Rule 13(b).

11. We note that Justices Roberts, Reed, Frankfurter, and Jackson disagreed with the majority's balancing of the competing policies:

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brought as a response to a patent infringement action, nor, here is there a similar policy factor, *Mercoid* does not prevent the application of res judicata principles. Nothing in *Mercoid* justifies Martino's argument that *Mercoid* generally prohibits application of res judicata to antitrust claims. *See Beacon Theatres, Inc.* v. *Westover,* 359 U. S. 500, 508 (1959); *United States* v. *Eastport Steamship Corp.,* 255 F. 2d 795, 805 (2d Cir. 1958); *Switzer Bros.* v. *Lochlin,* 207 F. 2d 483, 488 (7th Cir.), *cert. denied,* 347 U. S. 912 (1953).

Accordingly, the judgment of the district court is affirmed.

AFFIRMED.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

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(Footnote continued from preceding page.)

> I fail to see what great question of public policy is violated by holding that one to whom a defense was available, in rebuttal of a claim broader than was warranted by the statute on which the plaintiff's right was founded, is bound by the judgment rendered. . . . We are now told that a misconstruction of the patent law by a licensor is so violent and flagrant a flouting of the public interest that a court of equity must hold its hand for the benefit of a defendant whenever he chooses to invoke that interest for his private benefit, though he has failed to make the defense in an earlier litigation and stands of record an infringer. If a wrong against the public has been perpetrated it may be redressed at the instance of the representatives of government. 320 U. S. at 675. (Roberts, J., joined by Reed, Frankfurter, and Jackson, J.J., dissenting.)

OPINION BY JUDGE PELL

UNITED STATES COURT OF APPEALS
for the Seventh Circuit
Chicago, Illinois 60604

May 9, 1979

Before

HON. THOMAS E. FAIRCHILD, *Chief Judge*
HON. WILBUR F. PELL, JR., *Circuit Judge*
HON. HARLINGTON WOOD, JR., *Circuit Judge*

LOUIS J. MARTINO and McDONALD'S DRIVE-IN OF OTTUMWA, IOWA, INC.,
Plaintiff-Appellants,

No. 78-1480 *vs.*

McDONALD'S SYSTEM, INC., etc., and FRANCHISE REALTY INTERSTATE CORPORATION, etc.,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 75-C-3455

Joel M. Flaum, Judge.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this court filed this date.

UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

Name of Presiding Judge, Honorable Joel M. Flaum

Cause No. 75 C 3455 Date May 18, 1977

Title of Cause—Louis J. Martino, et al. v. McDonald's System, Inc. et al.

Brief Statement of Motion—Memorandum Opinion

Enter memorandum opinion. Corporate plaintiff, McDonald of Ottumwa is hereby dismissed with leave to reinstate. Judgment is hereby entered for the defendants on Count I of the plaintiff's complaint. (DRAFT)

/s/ Joel M. Flaum
Judge

UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

LOUIS J. MARTINO and McDONALD'S DRIVE-IN OF OTTUMWA, IOWA, INC., *Plaintiffs,*

vs.

McDONALD'S SYSTEM, INC., and FRANCHISE REALTY INTERSTATE CORPORATION, *Defendants.*

75 C 3455

MEMORANDUM OPINION

JOEL M. FLAUM, District Judge:

Before the court is the defendants' motion to dismiss or for summary judgment on plaintiffs' complaint alleging violations of the federal antitrust laws. In count I of the complaint, Martino and the corporate plaintiff McDonald's of Ottumwa challenge a provision of the McDonald's System franchise agreement prohibiting acquisition of financial interest in competing self service food establishments without consent of the franchisor. Count II of the plaintiffs' complaint challenges a rebate arrangement between defendant McDonald's Systems and Coca-Cola Corporation.

The threshold issues to be resolved concern the standing and capacity of the individual and corporate plaintiffs. Plaintiff Martino was a franchisee of defendant McDonald's Systems on an agreement executed in June of 1962. That franchise was not assigned to plaintiff McDonald's of Ottumwa, and plaintiff Martino retained the interest in the franchise indi-

vidually.[1] Although the allegations of the complaint are less than clear as to the capacity in which plaintiff Martino is seeking relief, the complaint arguably states a claim by plaintiff in his individual capacity as franchisee. Accordingly, the authority relied upon by defendants holding that an individual shareholder lacks standing to sue for alleged antitrust violations which merely affect the value of his shares is inapplicable. *See e.g., Vincel* v. *White Motor Corp.*, 521 F. 2d 1113 (2d Cir. 1975).

The question of the capacity of the corporate plaintiff, McDonald's of Ottumwa, is more complex. It appears that the corporation was organized to operate the franchise owned by the individual plaintiff. McDonald's of Ottumwa did not hold the franchise as a corporate asset. However, by the loss of the franchise, the shares of McDonald's of Ottumwa were allegedly adversely affected. Thus it is arguable that the corporation, although not the franchisee, may establish some basis for a claim against defendants for the alleged antitrust violations. The difficulty for the corporate plaintiff is not one of standing, rather it is one of capacity. It is uncontested that the corporate plaintiff's certificate of incorporation was cancelled by the Iowa Secretary of State on November 22, 1974 pursuant to Iowa law. This suit was commenced in October of 1975 at which time the plaintiff corporation lacked capacity to sue under Iowa law. In April of 1976 plaintiff reacquired corporate capacity, and the certificate of cancellation was revoked. The federal rules require that corporate capacity be determined with reference to the state of domicile, thus in the instant case, the law of the state of Iowa must be examined.

The controlling Iowa statute provides that "the cancellation of the certificate of incorporation of a corporation shall not take away or impair any remedy available to or against such cor-

1. Although this statement is contrary to the allegations of the complaint, both parties agree that the franchise was not validly assigned to the plaintiff corporation. For purposes of simplicity the court will examine the issues in this factual context, assuming that an appropriate amendment to the complaint will be forthcoming.

poration . . . for any right or claim existing or any liability prior to such cancellation, but no action or proceeding thereon may be prosecuted by such corporation until it shall have been reinstated." Iowa Code Ann. ch. 496A, § 130. The language of this section indicates that the corporate plaintiff lacked legal capacity to sue at the time this action was commenced, and the defendants argue that Iowa law holds that subsequent reinstatement of the certificate of incorporation is ineffective to retroactively restore capacity to the corporate plaintiff in this action. Defendants' argument is predicated on *Hearth Corp.* v. *CBR Development Co., Inc.,* 210 N. W. 2d 632 (1973) in which the Iowa Supreme Court interpreted the provisions of this statute to preclude a corporation which reacquired a certificate of incorporation from enforcing a contract which was executed during the time of corporate disability prior to reinstatement. The Iowa statute does not affect the validity of actions which predate cancellation or postdate reinstatement. Rather it affects the enforcibility of transactions entered into during the cancelled period as in *Hearth.* Thus the court in *Hearth* did not reach the issue of reacquisition of capacity on the maintenance of an action which is itself enforcible because it arose during the precancellation period. That precise issue was examined by an Iowa district court eight months prior to the *Hearth* decision in *Stutzman Feed Service Inc.* v. *Todd & Sargent Inc.,* 336 F. Supp. 417 (S. D. Iowa 1972) and the district court specifically directed its statutory interpretation to the section of the code governing the instant action. In *Stutzman,* the district court reasoned that the reinstatement related back to the date of cancellation and that reinstatement after commencement of an action by a cancelled corporate plaintiff would suffice to establish capacity to continue to maintain the action. The *Hearth* case did not cite *Stutzman,* and there is no indication in that opinion that the court was interpreting the "no action or proceeding thereon may be prosecuted . . . until it shall have been reinstated" provision of the Iowa code. The issue in *Hearth* was the enforcibility of a contract executed by

the cancelled corporation, and the holding that reinstatement did not validate the contract need not dictate dismissal of the reinstated corporate plaintiff in this federal action. Admittedly the rationale for *Stutzman*, that the code contemplated an uninterrupted existence by reinstatement, cannot be reconciled with the holding in *Hearth*, that the corporate plaintiff was incapable of executing enforcible agreements during its cancellation period.

While the rationale in *Stutzman* and the holding in *Hearth* cannot be reconciled, the decisions may be harmonized by the application of the federal rules. In the instant case, as in *Stutzman*, the action when commenced may have been void as to the corporate plaintiff, however, the liberal amendment policy of the federal rules permits a plaintiff who reacquires capacity to amend the complaint to moot the capacity problem. Fed. R. Civ. P. 15; Wright & Miller, Federal Practice & Procedure § 1474. If an appropriate amendment is presented to the court, the corporate plaintiff may be determined to be a proper and qualified party to this action and the parties may at that time brief the "relation back" issue and the effect of amendment on the statute of limitations. On the pleadings before the court it is clear that under *Hearth* and the reasoning of *Stutzman*, the corporate plaintiff lacked capacity to prosecute this action when it was commenced. Accordingly, the corporate plaintiff is dismissed with leave to reinstate by appropriate amendment.

The defendants' substantive objections to the maintenance of this action arise from earlier litigation between defendant McDonald's Systems and the individual plaintiff Martino in connection with an alleged breach of the franchise agreement. Defendants argue that Martino executed a release in the prior suit, that defendant is barred from raising this cause of action by the compulsory counterclaim rule, and that res judicata precludes assertion of the instant action. As the resolution of these issues hinges on the scope of the original litigation, the procedural history of that action is a necessary preface to the court's analysis.

One provision of the franchise agreement between Martino [and three other franchisees not involved in this action] and McDonald's Systems prohibited acquisition of financial interest by the franchisee or a member of his immediate family in competing self service food businesses without written consent of defendants. In 1968 Martino allegedly violated this provision, and in 1972 McDonald's Systems sued in the federal district court for the Southern District of Iowa to terminate the Martino franchise. The franchisees filed motions to strike or for a more definite statement in the action, and these motions were denied by the Iowa District Court on February 2, 1973. No answer was filed by the franchisees subsequent to that date and no appropriate motion was advanced by the McDonald's Systems plaintiff in that action. Apparently settlement negotiations were proceeding and these negotiations culminated in a settlement agreement that was entered by the court on September 5, 1973. The terms of the settlement agreement provided that the franchisees sell the franchise to McDonald's Systems and Franchise Realty Interstate Corporation (FRIC) for $140,000 pursuant to an agreement executed August 10, 1973. The provisions of that sale agreement were not incorporated by reference into the consent decree of September 5, 1973.

The first contention of defendants is that certain language in the August 10, 1973 sales agreement constitutes a release of the substance of this and all claims by plaintiff against McDonald's Systems. The language relied on by defendants is that the franchisees "agree to indemnify and hold harmless Buyer [herein defendants] . . . from any and all claims and causes of liability arising out of seller's [herein plaintiff's] ownership, maintenance and/or operation of said premises prior to takeover date." This language does not on its face bar any and all claims of plaintiff arising from the franchise agreement or termination, and on a motion for summary judgment this court cannot say as a matter of law that this language precludes the instant action.

Similarly, the court finds no factual or legal support for defendants' contention that language in the sales agreement pro-

viding that the franchisees, Martinos, sold "all rights, title and interest of all assets, tangible and intangible" to McDonald's Systems and FRIC operates as an assignment of the instant antitrust action.

The second contention asserted by McDonald's Systems is that the antitrust claims alleged in this lawsuit were compulsory counterclaims in the earlier Iowa litigation, thus failure to raise those claims in that action bars this subsequent litigation. Fed. R. Civ. P. 13(a). The plaintiff's complaint alleges two violations of the federal trade regulations, count I alleges restrictive agreements and count II alleges an illegal tying arrangement. A counterclaim is considered compulsory under rule 13(a) if it bears a "logical relationship" to the primary claim asserted, and failure to plead such a related claim forecloses later litigation. *See e.g., Pipelines Local Union No. 798* v. *Ellerd,* 503 F. 2d 1193 (10th Cir. 1974); *United States* v. *Heywood-Robinson Co.,* 430 F. 2d 1077 (2d Cir. 1970). The concepts underlying this logical relationship analysis are apparent:

> The phrase logical relationship is given meaning by the purpose of the rule which it was designed to implement. Thus a counterclaim is logically related to the opposing party's claim where separate trials on each of their respective claims would involve a substantial duplication of effort and time by the parties and the courts. Where multiple claims involve many of the same factual and legal issues, or where they are offshoots of the same basic controversy between the parties, fairness and considerations of convenience and economy require that the counterclaimant be permitted to maintain his cause of action.

Great Lakes Rubber Corp. v. *Herbert Cooper Co.,* 286 F. 2d 631, 634 (3rd Cir. 1961). Application of this logical relationship analysis persuades the court that the action asserted in count I of plaintiff's complaint challenging the legality of the very provision under which the Martino franchise was terminated is logically related to the contract action in which Martino forfeited the franchise for violation of the provision. The Iowa

consent decree necessarily rests on the provision which the plaintiff now challenges, and that judgment assumes its validity and enforcibility. Certainly a franchisee must be free to challenge restrictive provisions in a franchise contract, however, such a challenge is a compulsory counterclaim if the franchisor seeks termination of the franchise for violation of the purportedly illegal terms.

The logical relationship between the plaintiff's allegations in count I and the basis of the Iowa termination action is apparent on its face. No such logical relationship may be discerned as to the claim asserted in count II of plaintiff's complaint. Count II challenges an entirely different provision of the contract which relates to the operation of the franchise in purchasing beverages. There is some evidence in the record that the parties considered express reservation of this claim from the scope of the Iowa consent decree, however, the understanding of the parties is not determinative of this issue. That evidence merely reflects the view of the parties that the tying claim is separate from the breach of terms issue, an assessment with which the court concurs. The legality or enforcibility of the tying arrangement is not logically related to the contract termination action, thus the claim in count II would have been a permissive counterclaim in the Iowa litigation. Fed. R. Civ. P. 13(b).

Plaintiff's opposition to the applicability of rule 13(a) is premised on *Mercoid* v. *Mid-Continent Investment Co.*, 320 U. S. 661 (1944) in which the Supreme Court held that an antitrust counterclaim in a patent infringement action is a permissive counterclaim under rule 13(b), thus failure to assert the claim in an infringement action by the patentee did not preclude subsequent litigation of the alleged antitrust violations in connection with marketing the patent. Several courts have read the *Mercoid* language expansively, holding that *Mercoid* entirely exempts antitrust actions from the scope of rule 13(a). *See, Reagan* v. *Commonwealth Theatres of Puerto Rico*, 300 F. Supp. 676 (D. C. P. R. 1969); *Cf. Canned Foods Inc.* v.

United States, 146 F. Supp. 470 (Ct. Cl. 1956). This court is persuaded that the more persuasive authorities have restricted the *Mercoid* holding to patent misuse claims. *See, e.g., Switzer Bros. Inc.* v. *Locklin,* 207 F. 2d 483 (7th Cir. 1953); *Cf. United States* v. *Eastport Steamship Corp.,* 255 F. 2d 795 (2d Cir. 1958). *See generally* Wright & Miller, Federal Practice & Procedure § 1412. Accordingly, the court rejects the plaintiff's contention that a claim under the Sherman or Clayton Act cannot be construed as a compulsory counterclaim under rule 13(a).

Although this court has determined that plaintiff's claim in count I would have been a compulsory counterclaim in the Iowa litigation, the procedural context of this action prevents the claim from fitting comfortably into the preclusion principle whereby an unasserted counterclaim is barred from subsequent litigation under rule 13(a). Whether the operation of the rule is framed in terms of estoppel, waiver or res judicata, it is clear that rule 13(a) articulates a rule of preclusion adopted to foreclose subsequent federal litigation of issues which should properly have been resolved in an earlier action. The Advisory Committee Notes to rule 13(a) support this premise, indicating that "[i]f an action proceeds to judgment without the interposition of a counterclaim as required by subdivision (a), the counterclaim is barred." Yet the actual language of the preclusion rule does not incorporate that concept. Rule 13(a) simply provides that a "pleading shall state as a counterclaim any claim . . . the pleader has against the opposing party if it arises out of the same transaction or occurrence that is the subject matter of the opposing party's claim." The rule does not specifically address a principle of preclusion in cases in which no appropriate pleading, i.e., answer, has been filed. Fed. R. Civ. P. 8(b). As no answer was filed by plaintiff Martino in the Iowa litigation prior to the consent judgment, the express applicability of rule 13(a) to the instant case is unclear. Thus the court must determine whether the filing of an answer is a prerequisite for claim preclusion under the rule.

In interpreting the state analogues to federal rule 13(a) several state courts and the Ninth Circuit Court of Appeals have concluded that the rule governs in the absence of an answer if the action proceeds to judgment without assertion of the compulsory counterclaim. *See, e. g., Harris* v. *Jones,* 404 S. W. 2d 349 (Tex. App. 1966); *Mensing* v. *Sturgeon,* 250 Iowa 918, 97 N. W. 2d 145 (1959); *Keller* v. *Keklikian,* 362 Mo. 919, 244 S. W. 2d 1001 (1951); *Brenner* v. *Mitchum, Jones & Templeton Inc.,* 494 F. 2d 881 (9th Cir. 1974). Defendants have referred the court to a municipal court decision, *Firemen's Insur. Co.* v. *L. P. Steuart & Bros. Co* , 158 A. 2d 675 (D. C. Mun. App. 1960) which holds that failure to file an answer prior to default judgment does not except a claim from the bar of rule 13(a). The court is persuaded that these authorities represent a reasoned approach to the application of rule 13(a). To hold otherwise would place a premium on non-compliance with the federal rules, thus encouraging defendants to attempt to reserve by inaction and silence claims which could be expressly reserved in the consent judgment. *Cf. Benjamin* v. *United States,* 348 F. 2d 502 (Ct. Cl. 1965). In reviewing the circumstances of the instant case, the court concurs with the Ninth Circuit which "fail[ed] to see anything in the statute or in logic to support plaintiff's distinction" between answering and non-answering defendants where the action has proceeded to judgment on the merits, by default or by consent, without interposition of an answer asserting the compulsory counterclaim.

Plaintiff relies on *United States* v. *Thompson,* 262 F. Supp. 340 (S. D. Tex. 1966) in arguing that the rule requires the filing of an answer for applicability of the preclusion principle. In *Thompson* the court noted in dicta that filing a responsive pleading is a prerequisite to the applicability of the rule, however, that technical reading of the rule is not supported by the cited authorities and it was not necessary to the resolution of the case before the court. The defendants in *Thompson* urged that rule 13(a) precluded litigation of a claim which would

have been a compulsory counterclaim in an earlier action brought by them against the Government. In that prior action the Thompsons as plaintiffs took a voluntary dismissal with prejudice before the Government filed a responsive pleading. In holding that the Government's claim was not precluded by the Thompsons' voluntary dismissal prior to the Government's answer in the earlier litigation, the court recognizes that a plaintiff's tactical decision cannot foreclose a defendant's claim. Certainly this result is dictated by rule 41(a)(1) and (2), and it is not in conflict with the cases cited above holding that a non-answering defendant may be precluded from litigating issues which should have been pleaded in an earlier lawsuit.

Similarly, the plaintiff's reliance on *Lawhorn* v. *Atlantic Refining Co.*, 299 F. 2d 353 (5th Cir. 1962) is misplaced. *Lawhorn's* rule 13 argument was predicated on the defendant's failure to file a counterclaim in an earlier action which proceeded to judgment on defendant's rule 12(b) motion to dismiss. The Fifth Circuit reasoned that a counterclaim need not be asserted in an action in which the plaintiff failed to state a claim upon which relief may be granted. The court found that a valid claim by plaintiff is the necessary predicate for a compulsory counterclaim by defendant. While this court hesitates to adopt the reasoning of the Fifth Circuit as to the necessity of a valid plaintiff's claim as a prerequisite for applicability of rule 13, the court is persuaded that the results in *Lawhorn, Thompson,* and the default judgment cases discussed above can be reconciled into a single proposition. Where the defendant in an action is obligated to plead, *i.e.,* file an answer, failure to assert a compulsory counterclaim in such an answer precludes subsequent litigation on that claim. The obligation to plead by filing an answer arises within a proscribed time frame, either from commencement of the action, or denial of rule 12 motions. Thus, in *Thompson,* plaintiff's voluntary dismissal prior to the time in which defendant was obligated to answer could not preclude subsequent litigation of an unasserted claim. In *Lawhorn* the

favorable ruling on the defendant's motion to dismiss relieved the defendant from the obligation of filing an answer, therefore the unasserted counterclaim was not precluded under rule 13(a). In *Firemen's Insurance Co., supra,* the defendant's failure to answer and assert a compulsory counterclaim after becoming obligated to plead by valid service of process precluded subsequent action on the unasserted claim.

Thus rule 13 works a forfeiture whether cast in terms of res judicata, waiver or estoppel when a defendant is obligated to plead a compulsory counterclaim and fails to do so. In the context of a default judgment that obligation arises from passage of time, in the context of a voluntary plaintiff's dismissal or defendant's rule 12 motions that obligation does not arise at all. However, the application of this obligation to plead principle to the context of consent judgments is problematic. A consent decree may be entered prior to the date on which the defendant is obligated to answer, or it may be entered subsequent to the date on which pleading is required. In the instant case, the consent decree was entered nearly six months after the defendant became obligated to answer McDonald's Systems complaint and no answer was filed. Thus the obligation principle which harmonizes the cases discussed above as to the non-answering defendant could foreclose the claim in count I of plaintiff Martino's complaint. However, if the obligation to plead is the touchstone for the rule 13 bar, the non-answering defendant who enters a consent decree nineteen days after service of process could theoretically proceed on unasserted claims that are logically related to the settled claim while the non-answering defendant who enters a consent decree twenty-one days after service would be precluded by the obligation to plead analysis. Such a distinction would ignore both the concept of complete adjudication of actions embodied in rule 13 and the principle of finality of litigation toward which the rule is directed. Thus the obligation to plead by mere passage of time cannot be accepted as the ultimate analysis for precluding claims of non-answering defendants

under rule 13. Rather this court is persuaded that the interests of rule 13 are best served by a straightforward evaluation of the burden of the non-answering defendant to assert a compulsory counterclaim in the factual framework of the given case. Thus in the case of a default judgment, defendant's inaction in asserting a claim should result in forfeiture. In a consent agreement wherein the parties have consulted and compromised the issues between them, that agreement should represent settlement of those claims logically related to the principle action. In this context enforcement of the preclusion rule is premised on defendant's knowing failure to assert the claim prior to judgment even though that judgment may be entered in advance of the date for answering under the rules. The interests of judicial economy and fairness to the litigants are satisfied, and the purpose of rule 13(a) as set forth in the advisory notes is achieved.

This result is consistent with the analysis espoused by Professor Wright for determining whether a non-answering defendant's compulsory counterclaim is precluded by rule 13(a). Wright suggests that "if the doctrine of res judicata is employed as the basis for the barring effect of rule 13(a) then regardless of the type of judgment rendered [consent, default, or on the merits] the counterclaim will be barred in any subsequent action." Wright & Miller, Federal Practice & Procedure § 1417 at 97. The Seventh Circuit Court of Appeals has employed res judicata as the underpinning of rule 13(a), thus in this circuit a compulsory counterclaim not asserted in an earlier action is barred if the action proceeds to judgment regardless of the defendants' noncompliance with the federal rules. *Switzer Bros.* v. *Locklin*, 207 F. 2d 483, 488 (7th Cir. 1953).

This court's resolution is premised on the purposes and operation of rule 13(a); however, the same result is dictated by the principles of res judicata. *See e.g., Aerojet General Corp.* v. *Askew*, 511 F. 2d 710 (5th Cir. 1975); *Astron Industrial Asso. Inc.* v. *Chrysler Motors Corp.*, 405 F. 2d 958 (5th Cir. 1968). While this court need not determine whether rule 13(a) and

the federal law of res judicata are coextensive or supplementing principles, in this case it is clear that neither would permit a litigant to impair the rights established in an earlier action.

The applicability of rule 13(a) or general res judicata principles to the corporate plaintiff, McDonald's of Ottumwa need not be expressly decided at this time as that plaintiff has been dismissed with leave to amend. The court notes, however, that the exact identity of issues and parties may well dictate the same disposition for count I if the corporate plaintiff is reinstated.

In summary the court finds that Martino in seeking damages to the value of his franchise rather than to the shares of his corporate interest may proceed in this action as a proper plaintiff. The corporate plaintiff, McDonald's of Ottumwa, lacked capacity at the time this action was commenced and is hereby dismissed with leave to reinstate. The court further finds that the claim alleged in count I of plaintiff's complaint would have been a compulsory counterclaim in the earlier franchise termination action by McDonald's Systems and Martino's failure to assert that claim in the earlier action precludes litigation in this forum. Judgment is hereby entered for the defendants on count I of the plaintiff's complaint as that claim is barred by rule 13(a) and res judicata.

/s/ JOEL M. FLAUM
United States District Judge

Dated: May 18, 1977

UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

Name of Presiding Judge, Honorable Joel M. Flaum

Cause No. 75 C 3455 Date March 6, 1978

Title of Cause—Louis J. Martino, et al. v. McDonald's Systems, Inc., et al.

Brief Statement of Motion—order.

Plaintiff's motion to reconsider is denied. (DRAFT)

Flaum, J.

UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division

LOUIS J. MARTINO and McDONALD'S DRIVE-IN OF OTTUMWA, IOWA, INC., an Iowa corporation, individually and on behalf of all others similarly situated, *Plaintiffs,* *vs.* McDONALD'S SYSTEM, INC., an Illinois corporation and FRANCHISE REALTY INTERSTATE CORPORATION, an Illinois corporation, *Defendants.*	75 C 3455

MEMORANDUM OPINION

JOEL M. FLAUM, District Judge:

Plaintiff's motion to reconsider this court's May 18, 1977 order is denied. Defendant's motion for summary judgment on Count I of plaintiffs' complaint as to plaintiff McDonald's of Ottumwa is granted on the basis of this court's prior May 18, 1977 order. Thus, since McDonald's of Ottumwa is in privity with Louis Martino, it, like Mr. Martino, is barred from raising the claims in Count I because of Fed. R. Civ. P. 13(a) and *res judicata* principles. *See Aerojet General Corp.* v. *Askew*, 511 F. 2d 710 (5th Cir. 1975); *Martino* v. *McDonald's System, Inc.*, 432 F. Supp. 499, 508 (N. D. Ill. 1977).

It is so ordered.

/s/ JOEL M. FLAUM
United States District Judge

Dated: March 6, 1978.

UNITED STATES DISTRICT COURT

Northern District of Illinois

Eastern Division

Name of Presiding Judge, Honorable Joel M. Flaum

Cause No. 75 C 3455 Date March 20, 1978

Title of Cause—Louis J. Martino, et al. v. McDonald's System, Inc., et al.

The Judgment Order of March 6, 1978 is hereby amended to include the following statement: The court directs that a final judgment be entered in favor of the defendants as to Count I of the complaint. The court finds that there is no just reason for delay for the entry of such a final judgment. This finding is made pursuant to Fed. R. Civ. P. 54(b).

It is so ordered.

/s/ JOEL M. FLAUM
United States District Judge

Dated: March 20, 1978.

Supreme Court, U.S.
FILED
NOV 5 1979
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-566

LOUIS J. MARTINO AND McDONALD'S DRIVE-IN OF OTTUMWA, IOWA, INC.,

Petitioners,

vs.

McDONALD'S SYSTEM, INC. AND FRANCHISE REALTY INTERSTATE CORP.,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-566

LOUIS J. MARTINO AND McDONALD'S DRIVE-IN OF OTTUMWA, IOWA, INC.,

Petitioners,

vs.

McDONALD'S SYSTEM, INC. AND FRANCHISE REALTY INTERSTATE CORP.,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

Petitioners Louis J. Martino ("Martino") and McDonald's Drive-In of Ottumwa, Iowa, Inc. ("McDonald's of Ottumwa") seek review of the Court of Appeals' affirmance of the District Court's grant of summary judgment in favor of respondents McDonald's System, Inc. ("McDonald's") and Franchise Realty Interstate Corporation ("Franchise Realty") on Count I of petitioners' two-count complaint. None of the relevant considerations governing review on certiorari, as set forth in this Court's Rule 19, supports the grant of the requested writ. The decision of the Court of Appeals is wholly consistent with the pertinent decisions of this Court and the other Courts of Appeals. Nor does the decision below merit review by this Court for any other reason.

QUESTION PRESENTED

An earlier action involving the same parties and the same contract provision was settled by entry of a consent decree and payment of $140,000 to petitioners. Subsequently, petitioners brought this action charging that respondents' enforcement of the contract provision by bringing the earlier action and obtaining the consent decree violated the antitrust laws.

The question presented is whether the Court of Appeals correctly held that petitioners, in the particular circumstances of this case, are barred under principles of *res judicata* from collaterally attacking the earlier decree and nullifying rights established in the earlier action.

STATEMENT OF THE CASE

The Franchise Agreement

Petitioners' action arises out of a franchise agreement authorizing petitioner Louis J. Martino and three of his brothers to operate a McDonald's restaurant owned by respondents and located in Ottumwa, Iowa.[1] Petitioners sold their interest in the Ottumwa restaurant in 1973 as part of a settlement of earlier litigation between the parties in the United States District Court for the Southern District of Iowa, *Franchise Realty Interstate Corporation and McDonald's System, Inc.* v. *Louis J. Martino, et al.*, No. 72-194-1.

Both the earlier litigation and Count I of the present complaint involve the same provision of the McDonald's franchise agreement for the Ottumwa restaurant. This provision prohibited the acquisition by the franchisee or by a member of the

1. Subsequent to the grant of the franchise in June, 1962, the corporate petitioner, McDonald's of Ottumwa, allegedly was formed by the Martinos to operate the Ottumwa restaurant. Louis Martino is now the sole shareholder, officer and director of McDonald's of Ottumwa.

franchisee's immediate family of a financial interest in another competing self-service food establishment without the written consent of the franchisor.

The Earlier Litigation

In the earlier litigation, commenced in 1972, McDonald's sued to terminate the Ottumwa franchise based on Louis Martino's alleged violation of this provision of the franchise agreement. That litigation was concluded in September 1973 by entry of a consent decree as part of a settlement negotiated by the franchisees and McDonald's (App. A19, 432 F. Supp. at 504).[2] In the consent decree, signed by the parties and their respective counsel, the District Court made specific findings of fact and conclusions of law, including the following finding and conclusion:

> "[That] the defendant, Louis J. Martino, or a member of his immediate family, has violated the terms of the sublease and the franchise agreement by engaging in a business in which food and beverages are dispensed other than the location covered by the agreements without the prior consent of Franchise Realty or McDonald's System, and that such action constitutes a material breach of agreement sufficient to justify termination." (App. A6-A7, n. 8, 598 F. 2d at 1083 n. 8.)

The decree further provided that the parties had entered into an agreement for the sale of the property to a third party. Pursuant to this settlement, Martino, his brothers and McDonald's of Ottumwa (which was a signatory to the purchase and sale agreement) received $140,000 from the sale of the Ottumwa franchise (App. A2, 598 F. 2d at 1081).

The consent decree did not contain any reservation by the franchisees of any claim against McDonald's or Franchise Realty. Prior to the present suit, the consent decree was never

2. "App." refers to the Appendix (containing the decisions of the Court of Appeals and the District Court) included in the petition for certiorari.

challenged by Martino or any of his brothers. Nor has any attempt been made in the United States District Court for the Southern District of Iowa to vacate or amend the 1973 decree, which accordingly stands as a final binding judgment constituting an adjudication on the merits (App. A6-A7, 598 F. 2d at 1083).

The District Court Proceedings in This Case

On October 14, 1975, two years after the 1973 decree, the complaint in the present action was filed in the United States District Court for the Northern District of Illinois.

Count I charges that McDonald's enforcement of the contractual provision at issue in the prior litigation violated Section 1 of the Sherman Act, 15 U. S. C. § 1, and seeks damages allegedly resulting from the settlement of that litigation.[3] Count I (as amended), after referring to the earlier suit, the consent decree, the settlement, and the $140,000 payment (¶¶ 13-15), alleges that "[t]he unlawful termination *through legal proceedings* of plaintiff's business had a substantial impact on interstate commerce . . ." (¶ 16) and that the respondents had violated Section 1 of the Sherman Act by thus *"enforcing the provisions of the franchise agreement and the sub-lease . . ."* (¶ 17) (italics added).

On March 30, 1976, respondents moved to dismiss and for summary judgment on the ground, *inter alia,* that the plaintiffs were estopped and barred from maintaining this action by the consent decree entered in the prior lawsuit. The District Court granted the motion for summary judgment with respect to Count I of the complaint in its memorandum opinion dated May 18, 1977 (App. A15-A27, 432 F. Supp. 499).

The District Court based its decision on both the compulsory counterclaim rule set forth in Rule 13(a), F. R. Civ. P., and on

3. Count II, which remains pending in the District Court, charges an illegal tie-in with respect to plaintiffs' purchases of Coca-Cola while a McDonald's franchisee.

principles of *res judicata* apart from Rule 13(a). In reaching this conclusion the District Court held:

> "The Iowa consent decree necessarily rests on the provision which the plaintiff now challenges, and that judgment assumes its validity and enforcibility." (App. A20-A21, 432 F. Supp. at 504.)

The District Court further ruled that "neither [Rule 13(a) nor principles of *res judicata*] would permit a litigant to impair the rights established in an earlier action" (App. A26-A27, 432 F. Supp. at 507).

On October 20, 1977, petitioners moved for reconsideration of the District Court's order.[4] In a memorandum opinion dated March 6, 1978 (App. A29), the District Court denied the motion for reconsideration and, on petitioners' motion, entered final judgment in favor of the respondents as to Count I pursuant to Rule 54(b), F. R. Civ. P., finding that there was no just reason for the delay in the entry of such final judgment (App. A30).

The Court of Appeals Decision

On appeal, the Court of Appeals affirmed the District Court's decision on the basis of *res judicata*. The Court ruled that petitioners' claim was not precluded by Rule 13(a) because no answer had ever been filed by petitioners in the Iowa litigation (even though an answer was long overdue when the case was settled). However, the Court held that even apart from Rule 13(a) "[b]oth precedent and policy require that res judicata bar a counterclaim when its prosecution would nullify rights established by the prior action"(App. A9, 598 F. 2d at 1085).

This principle was held to be controlling since "Martino's claim . . . is a direct attack on the termination rights established in the earlier judgment" (*ibid.*). The Court of Appeals pointed out that the decree entered by the federal court in Iowa "was

4. The District Court's ruling that Count I was barred under *res judicata* was not among the matters petitioners asked the District Court to reconsider.

accompanied by judicial findings of fact and conclusions of law that go to the merits of the controversy" in that Martino's actions were found to be "a material breach of the agreements sufficient to justify termination" (App. A6, 598 F. 2d at 1083). Accordingly, the Court of Appeals held, "It is impossible to interpret this count as anything but a direct challenge to the outcome of the 1973 lawsuit" (App. A7, 598 F. 2d at 1084).

ARGUMENT

At the outset, three significant facts concerning this case should be noted. *First,* not only does petitioners' present action attack the very contract provision which was the subject of the earlier action and the resulting consent decree, but more specifically their claim is that the enforcement of that contract provision by respondents' bringing and maintaining the earlier action violated the Sherman Act.

Second, as the courts below pointed out, the prior decree was not only squarely premised on the validity and enforceability of the very contract provision which petitioners now challenge as unlawful, but furthermore the decree specifically found that petitioners' actions constituted "a material breach of agreement sufficient to justify termination".

Third, petitioners' present antitrust argument—had it been raised and found meritorious—would have been a complete defense to enforcement of the contract provision and entry of the decree in the earlier action, "changing the outcome of the litigation" (App. A8, 598 F. 2d at 1084).

Nevertheless, it is petitioners' extraordinary position that they were perfectly free in the prior proceeding to consent to the decree and its specific findings, receive $140,000 as part of the settlement, say nothing about any antitrust objection to the contract provision or the suit, *and then—two years later in another federal district court—spring their antitrust attack on the earlier action and the consent decree.*

The decision below, rejecting that argument, is not in conflict with any decision of this Court. Nor is there any conflict between Circuits. Indeed, the only question presented by the decision below involves application of established principles to the particular circumstances of this case.

I.

The Decision Below Does Not Conflict with Any Decision of This Court or the Other Courts of Appeals.

In holding that the prior decree barred petitioners' collateral attack on the same contract provision and the earlier action, the Court of Appeals applied established principles, going back to this Court's decision in *Cromwell* v. *County of Sac*, 94 U. S. 351 (1876), which held that a judgment

> ". . . is a finality as to the claim or demand in controversy, concluding parties and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, *but as to any other admissible matter which might have been offered for that purpose. . . . If such defenses were not presented in the action, and established by competent evidence, the subsequent allegation of their existence is of no consequence.* . . . [A] judgment estops not only as to every ground of recovery or defense actually presented in the action, but also as to every ground which might have been presented. . . ." (94 U. S. at 352, 353; italics added.)

See also, e.g., *Angel* v. *Bullington*, 330 U. S. 183, 193 (1947); *Aerojet-General Corp.* v. *Askew*, 511 F. 2d 710, 718 (5th Cir.), *cert. denied*, 423 U. S. 183 (1975).

Quoting this well-settled rule, and applying it to the particular facts of this case, the Court of Appeals pointed out that the *res judicata* effect of a judgment "comprises defenses, such as the alleged antitrust violation here, that were or might have been raised." (App. A8, 598 F. 2d at 1084.) More specifically, the Court of Appeals held that "Both precedent and policy re-

quire that res judicata bar a counterclaim when its prosecution would nullify rights established by the prior action." (App. A9, 598 F. 2d at 1085.)

Thus, for example, in *Chicot County Drainage District* v. *Baxter State Bank,* 308 U. S. 371 (1940), "a case similar in relevant respects to the one before us" (App. A9, 598 F. 2d at 1085), this Court held that a decree effecting a plan of readjustment of indebtedness, which resulted in a cancellation of certain bonds pursuant to the Readjustment Act of 1934, precluded a subsequent suit involving the same bonds which alleged that the Readjustment Act was unconstitutional. This Court held that the subsequent action was barred—even though the constitutional issue was not actually litigated in the earlier proceeding—because ". . . having failed to raise the question in the proceeding to which they were parties and in which they could have raised it and had it finally determined, [plaintiffs were not] privileged to remain quiet and raise it in a subsequent suit" (308 U. S. at 378).[5]

Numerous cases are to like effect—even where, as in *Chicot County,* the omitted defense was constitutional in nature. See, e.g., *Lovely* v. *Laliberte,* 498 F. 2d 1261, 1262-63 (1st Cir.), *cert. denied,* 419 U. S. 1038 (1974); *Coogan* v. *Cincinnati Bar Ass'n.,* 431 F. 2d 1209, 1211 (6th Cir. 1970); *Blankner* v. *City of Chicago,* 504 F. 2d 1037, 1042 (7th Cir. 1974), *cert. denied,* 421 U. S. 948 (1975). *A fortiori,* the same doctrine has been frequently applied to non-constitutional claims, e.g., *Aerojet-General Corp.* v. *Askew, supra* at 718; *Miller* v. *Meinhard-Commercial Corp.,* 462 F. 2d 358, 360-361 (5th Cir.

5. See also Restatement (Second) of Judgments § 56.1(2)(b) (Tent. Draft No. 1, 1973) which states that:

> "A defendant who may interpose a claim as a counterclaim in an action but fails to do so is precluded, after rendition of judgment in that action, from maintaining an action on the claim if . . . [t]he relationship between the counterclaim and the plaintiff's claim is such that successful prosecution of the second action would nullify the initial judgment or would impair rights established in the initial action."

1972); *Mitchell* v. *Village Creek Drainage District,* 158 F. 2d 475, 477-478 (8th Cir. 1946); *Moore* v. *Harjo,* 144 F. 2d 318, 322-323 (10th Cir. 1944).

Furthermore, *res judicata* principles have been applied to antitrust claims in the same manner as non-antitrust claims. See, e.g., *Norman Tobacco & Candy Co.* v. *Gillette Safety Razor Co.,* 295 F. 2d 362, 363-364 (5th Cir. 1961); *Engelhardt* v. *Bell & Howell Co.,* 327 F. 2d 30, 32 (8th Cir. 1964); *Becker* v. *Crown Central Petroleum Corp.,* 1977-1 Trade Cases ¶ 61,527 (D. Md. 1975), at 72,062; *Nash County Board of Education* v. *Biltmore Co.,* 1979-2 Trade Cases ¶ 62,846 (E. D. N. C. 1978) at 78,869, 78,873.

Petitioners' argument that the decision below is inconsistent with this Court's decision in *Mercoid Corp.* v. *Mid-Continent Investment Co.,* 320 U. S. 661 (1944), is fallacious. The Court of Appeals carefully considered the *Mercoid* case, and explained why it did not apply here (App. A11-A12, 598 F. 2d at 1086).

Mercoid involved an issue of patent misuse. In an earlier patent infringement action brought by Mid-Continent, the defendant (Smith) had not asserted a defense based on patent misuse. However, in the subsequent *Mercoid* case (involving a second infringement action brought by Mid-Continent), a different defendant (Mercoid) responded to the complaint by alleging that the plaintiff (Mid-Continent) had conspired with its licensee to unlawfully expand the patent monopoly to unpatentable products. In those circumstances, this Court declined to apply *res judicata* because of the strong public policy "which has led this Court in the past to withhold aid from a patentee in suits for either direct or indirect infringement where the patent was being misused" (320 U. S. at 670).[6]

By contrast, in the instant case: (1) no issue of patent misuse is involved here; (2) as the court below pointed out (App. A11-A12, 598 F. 2d at 1086), the present action was not brought by respondents or as a response to some new

6. Mr. Justice Roberts, joined by Justices Frankfurter, Reed and Jackson, dissented (320 U. S. at 675).

lawsuit brought by respondents; and (3) as the court below also pointed out, this "Court's res judicata analysis in *Mercoid* . . . was no different than ours here" (App. A11, 598 F. 2d at 1086). Unlike the present situation, the *Mercoid* case did not involve a collateral attack on the prior judgment that Mid-Continent's patent was valid and had been infringed. Such a judgment is not inconsistent with the assertion of a patent misuse claim since patent misuse does not invalidate a patent but (until "purged") merely prevents its enforcement even though the patent is valid and infringed. *Morton Salt Co.* v. *G. S. Suppiger Co.*, 314 U. S. 488, 492-93 (1942). Here, on the other hand, Martino's claim that McDonald's enforcement of the noncompetition clause in the franchise agreement violated the antitrust laws is a direct attack on the prior decree which "assumes [t]he validity and enforcibility" of the contract provision. Permitting assertion of such a claim now would clearly nullify rights determined in the earlier action and undermine a settlement resulting in a payment to petitioners of $140,000. (App A9-A11, 598 F. 2d at 1085.)

Thus, as the Court of Appeals held, *Mercoid* does not remotely establish a broad rule, as petitioners assert (p. 6), prohibiting application of *res judicata* to antitrust claims, and petitioners do not cite a single decision of any Court of Appeals so holding.[7] There is no conflict, either between Circuits or with any decision of this Court.

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7. The cases cited by petitioners as "following" *Mercoid* (p. 7, n. 2) involve a wholly separate issue—on which the Court of Appeals explicitly declined to express a view—whether *Mercoid* classifies all antitrust counterclaims as permissive counterclaims under Rule 13, F. R. Civ. P. Indeed, since the court below based its decision on *res judicata,* and not Rule 13, cases "following" *Mercoid* on Rule 13 cannot possibly be in conflict with the decision below.

Moreover, most of these cases, like *Mercoid,* involve patent misuse counterclaims in patent infringement cases and thus do not support any broad rule even with respect to Rule 13. See, e.g., *Beacon Theatres, Inc.* v. *Westover,* 359 U. S. 500, 508 (1959); *United States* v. *Eastport Steamship Corp.,* 255 F. 2d 795, 805 (2d Cir. 1958); *Switzer Bros., Inc.* v. *Locklin,* 207 F. 2d 483, 488 (7th Cir.), *cert. denied,* 347 U. S. 912 (1953). See also *Hancock Oil Co.* v. *Universal Oil Products Co.,* 115 F. 2d 45, 47 (9th Cir. 1940), *cert. denied,* 314 U. S. 666 (1941).

II.

Petitioners' Other Objections to the Decision Below Are Wholly Without Merit.

A. A "Cause of Action", for the Purpose of Determining the Res Judicata Effect of a Judgment, Comprises Defenses Which Were or Could Have Been Raised.

As the Court below stated, "The well-settled rule for the purpose of determining the res judicata effect of a judgment is that a 'cause of action' comprises defenses, such as the alleged antitrust violation here, that were or might have been raised." (App. A8, 598 F. 2d at 1084, citing *Cromwell* and *Chicot County* cases, *supra.*) Similarly, Professor Moore points out that one of the tests used for this purpose is "whether 'there is such a measure of identity that a different judgment in the second [action] would destroy or impair rights or interests established by the first' judgment". 1B Moore's Federal Practice, ¶ 0.410[1], p. 1158 (2d ed. 1974).[8] By either standard, the present action and the omitted claim in the prior action constitute a single "cause of action" for *res judicata* purposes, whatever may be the appropriate terminology in other contexts.

Petitioners, however, engage in semantic sleight-of-hand by arguing that for some other purposes the present action and the omitted claim in the prior action may be regarded as different "causes of action" (Pet. pp. 8-9). No doubt this is true, as the Court below recognized (App. A8, 598 F. 2d at 1084), in the sense that the prior suit was brought as a breach of contract action and the present suit as an antitrust action. But that is scarcely controlling for purposes of *res judicata.* Thus, in the *Chicot County* case, as the Court below pointed out (App. A9-A10, 598 F. 2d at 1085), the complaints in the two lawsuits were similarly based on two different theories—i.e., a suit by a bondholder to recover on certain bonds, and a statutory proceeding instituted by the issuer of the bonds to effect a plan

8. See also Restatement, *supra,* footnote 5.

of readjustment of its indebtedness.[9] Nevertheless, this Court held that "all the elements necessary to constitute the defense of res judicata are present" and that "having failed to raise the question in the proceeding to which they were parties and in which they could have raised it and had it finally determined [the plaintiffs were not] privileged to remain quiet and raise it in a subsequent suit" (308 U. S. at 375, 378). In the instant case, as the Court of Appeals held (App. A9-A11, 598 F. 2d at 1085), the *Chicot County* case is indistinguishable and required the same holding here.

B. Petitioners' Contention That Rule 13(a) Preempts the Res Judicata Doctrine Was Never Presented Below and Is Patently Invalid.

In their petition for certiorari, petitioners for the first time contend that Rule 13(a), F. R. Civ. P., preempts *res judicata* and is solely determinative of whether a withheld counterclaim may be litigated in a subsequent action. As stated in *Miree* v. *DeKalb County, Georgia,* 433 U. S. 25, 33-34 (1977), "The fact that the asserted basis [for reversal] is so obviously an afterthought may be some indication of its merit, but since it was neither pleaded, argued nor briefed either in the District Court or in the Court of Appeals, [this Court should] not consider it."

Petitioners do not cite a single decision of this Court or any other court in support of their argument. Moreover, their argument is directly contrary to the Federal Rules Enabling Act. *Res judicata* is a substantive principle of federal law concerning the operation of judgments. E.g., *Angel* v. *Bullington,* 330 U. S. 183, 186-187 (1947); *Cleckner* v. *Republic Van and Storage Co., Inc.,* 556 F. 2d 766, 768-769 (5th Cir. 1977). As such,

9. Petitioners (Pet. p. 8) erroneously seize upon the same point made in the opinion below as evidencing recognition of two different "causes of action". Petitioners not only ignore the Court's statement of the "well-settled rule" (App. A8, 598 F. 2d at 1084) but also ignore the central point that "cause of action" is a variable term depending on the context and purpose.

it is a part of the substantive law which the Federal Rules of Civil Procedure must not "abridge, enlarge or modify." Federal Rules Enabling Act, 28 U. S. C. § 2072.

Petitioners would have the application of *res judicata* in the present case turn on the procedural technicality of whether an answer was filed in the earlier proceeding because Rule 13(a) refers to a "responsive pleading". According to petitioners' theory, they should be allowed to attack in a different court the decree which they consented to in the federal court in Iowa because the 1973 decree was entered without an answer having been filed in the earlier proceeding.

Petitioners offer no cogent reason why there must be uniformity between Rule 13(a) and *res judicata*. More specifically, they provide no reason why the filing of an answer should take precedence over the important public policy of respecting the finality of judgments and protecting those who justifiably rely on such judgments.

Furthermore, contrary to petitioners' argument, the Court of Appeals did not invent any new rules which have prejudiced petitioners. As pointed out above, the decision below is grounded on long-standing principles of *res judicata* going back over a century.

CONCLUSION

Having collected $140,000 from the sale of the Ottumwa McDonald's unit as part of the settlement of the earlier litigation, while at the same time consenting to the finding that McDonald's was entitled to termination of the franchise, petitioners cannot now be allowed to assert in a different forum that the termination was wrongful and that they are entitled to more than the $140,000 which they received. Reduced to its basics, petitioners' argument is simply that they have a right to withhold a claim from litigation as a matter of convenience or inadvertence, even though their claim would nullify the decree entered by the Iowa federal court in 1973.

The decision below does not conflict with the applicable decisions of this Court or of the other Courts of Appeals. Nor does it involve any important issue of federal law which has not previously been settled by this Court. For these reasons, the petition for certiorari should be denied.

Respectfully submitted,

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